

# Contractual Management in PPP Projects: Evaluation of Legal versus Relational Contracting for Service Delivery

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**Abstract:** The paper explores the extent to which effective relationships and legal factors are used to determine performance outcomes in public-private-partnership (PPP) procurement in the United Kingdom. The purpose is to demonstrate means for service improvement on PPP projects. PPP was formerly the public finance initiative for the construction and operation of complex services and facilities. Design, build, finance, and operate and design, build, and operate type contracts are considered. A legal-relational continuum is developed, relationships being assessed in terms of *trust* as an indicator of robustness, data being mobilized through action research and quantitative survey methods. It was found that there is variance in the perceived trustworthiness of clients in the context of their understanding and experience of PPP, and variance in support given to staff by their departments in developing relations was found to affect performance. A long-term tendency was identified to relinquish partnership relations in favor of legal and potentially adversarial contracting. Relationship management principles were also found to be lacking in both the public and private sector, relational contracting being predominantly reliant upon the behavior of individuals in their teams.

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## Introduction

The focus of this paper is public-private-partnership (PPP) procurement (formerly the private finance initiative or PFI), examining *relational* and *legal* contracting as modus operandi for performance. Contractual and human relationships are normally conceived as diametrically opposed methods of managing project uncertainty and hence risk. This paper explores the dynamic between *relational* and *legal* contracting. The legal ramifications of the way in which relationships in PPP projects are conducted are examined. The importance of the research is that PPP contracts offer a unique opportunity to explore how relationships operate over an extended period from the initial bidding and negotiation, through detailed design and construction, to the operation of major facilities. Data are derived from the United Kingdom as a leader in developing this market. The data informs the analysis as to how relationships are configured.

The case-based data is drawn from one of the most complex

areas of the application of PPP, involving political sensitivity in the public domain, sensitivity of relationships between private organizations, and confidentiality between individuals. The value of the paper is the analysis of how a bidding consortium, the special purpose vehicle (SPV), is constructed in terms of relationships at aggregate level and at a functional level within the SPV and with the client organization. The capacity to learn how to work as a single entity in order to accept and manage the whole-sale “basket” of transferred risks under complex forms of contract at the heart of PPP policy is explored. Trust is an indicator of relationship development. An analysis of trust, particularly the *components of trust* as a key element in a framework of trust, is presented to provide insight into the dynamics of relationship development.

An evaluation will be made of the central position that relationships have in cementing the bond and over time yielding a “bankable” resource that can be drawn upon if disputes and disagreements occur. Recommendations are made to improve

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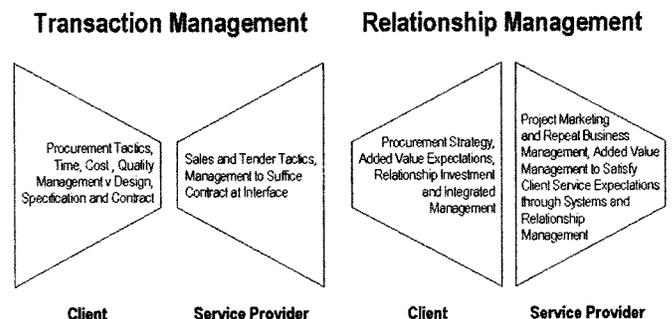
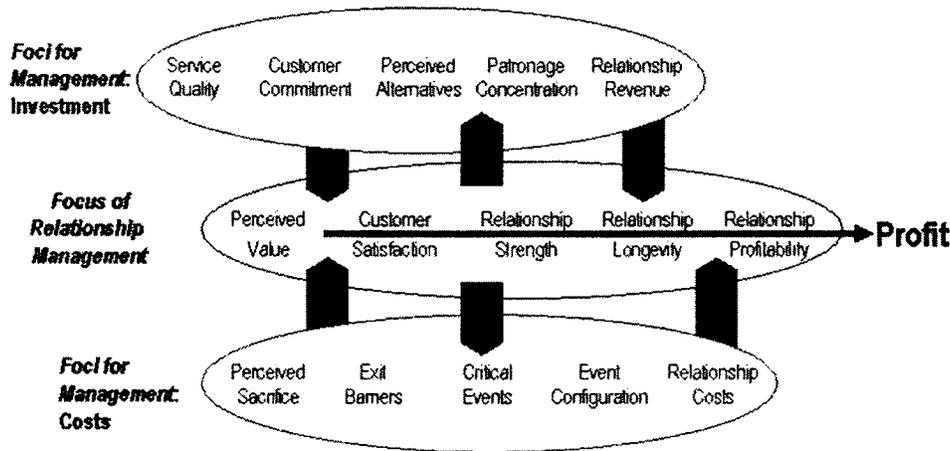


Fig. 1. Management approaches in exchange



Adapted from Storbacka et al 1994

Fig. 2. Model of organizational relationship management

practice and establish what approaches are working best for PPP procurement.

### Relational and Legal Contracting

The term *relational contracting* has become a generic term used in partnering, supply chain management, and other formal and informal alliances. Practice has been informed by client-driven agendas to improve performance in cost and value terms [see, for example, Egan (1998) in the U.K. context]. Thus relational contracting is frequently viewed as a procurement driven tool, which is learned from the client and passed down the construction supply chain (Green and May 2003). This has induced some improvements for clients, although the scope for improvement has been constrained by suppliers neglecting to address marketing as the other side of the same procurement coin (Smyth 2005). This is conceptually important as relationship management has developed from the paradigm of *relationship marketing* [see, for example, Grönroos (2000); Gummesson (2001); Ford et al. (2003) in general business-to-business service relationships and Smyth (2000) for construction and related services]. *Relationship management* offers an alternative to transaction approaches to ex-

change (Fig. 1), reversing the management emphasis of cost reduction and meeting contract conditions via the minimum number of points of contact to management. It seeks to proactively understand the client through close contact in order to maximize the potential to satisfy the client and stakeholders.

Relationship management focuses upon systems and processes on the one hand and behavior from a cultural and psychological perspective on the other hand. A number of key concepts of relationship management have been developed, including perceived value, service satisfaction, customer loyalty, ties and actor bonds, relationship value, and relationship profitability (see, for example, Storbacka et al. 1994; Ford et al. 2003). A model for managing relationships in order to add value profitably has been developed (Fig. 2).

The model recognizes that a range of factors need managing in order to translate effective relationship management into a quality service that yields a return on investment. On projects, what happens at an organizational level is not necessarily transferred to the project level. Therefore an amended model is needed at the project level (Fig. 3).

The critical factors differ to an extent at the project level. This project model does not replace the organization level one. The project model will only work with support from the organization

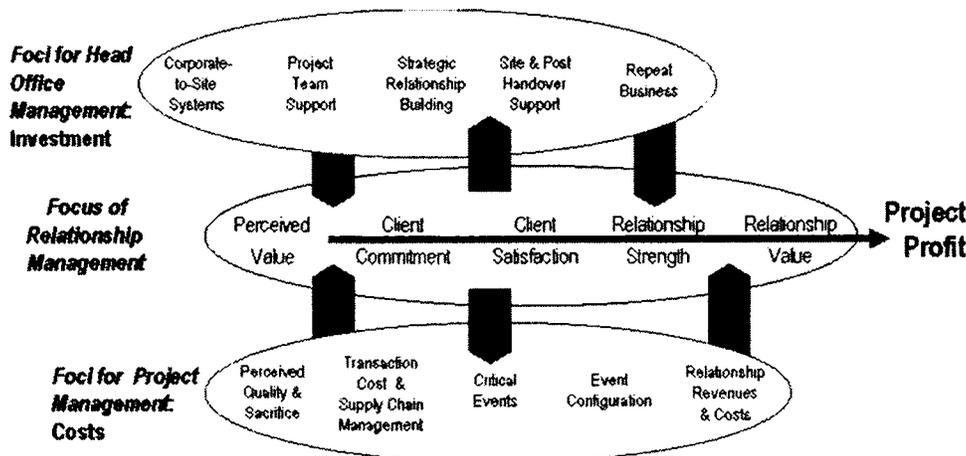


Fig. 3. Model of project relationship management

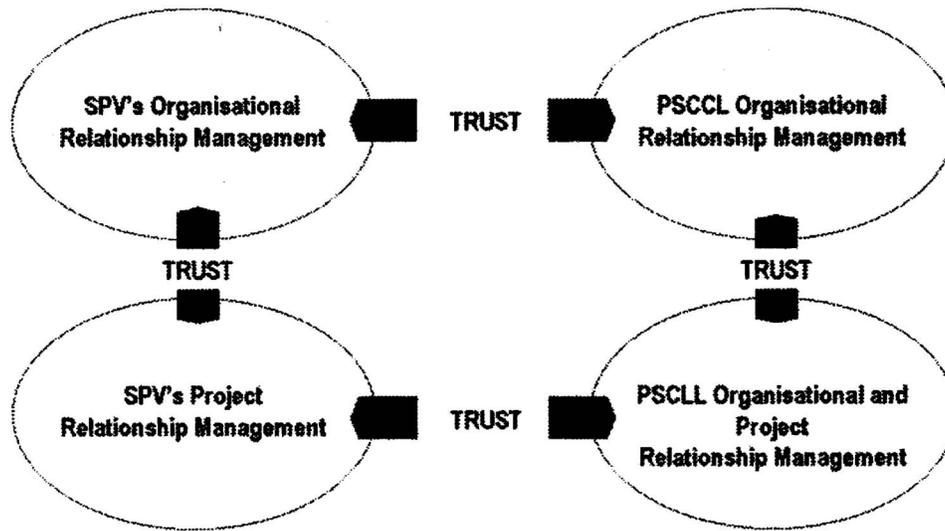


Fig. 4. Trust in key relations in PPP projects

as a whole. The strength of the relationship at the customer-supply interface is only as strong in the long run as the internal relations (Reichheld 1996), hence the need for organizational support. Trust has been identified as a key part of management both in the relationship management literature and a broader body of literature on trust. Trust is a robust measure of the strength of relationships (Gummeson 2001; Ford et al. 2003; and in construction Smyth and Thompson 1999; Wood et al. 2001; Smyth 2003; Smyth and Thompson, unpublished 2005). Trust has also been cited by policy makers and practitioners as a key element in project practice (see, for example, Egan 1998). Trust is therefore a key measure for establishing the performance of contracts through relationship management. Internal relations must be developed first; the most critical relation in terms of both systems and people is between the organization and project. As this develops, so will external relations, as demonstrated in the PPP context in Fig. 4.

There are many definitions of trust, and so for thoroughness and clarity the following is being used:

*Trust is a disposition and attitude concerning the willingness to rely upon the actions of or be vulnerable toward another party, under circumstances of contractual and social obligations, with the potential for collaboration.* (Smyth 2003)

At a practical operational level, trust is both a verb and noun. Trust builds over time into something tangible: “trust” is synonymous with the accounting and legal term, “goodwill,” which is subscribed an investment value. At a conceptual level, seven key elements of a framework have been identified from the extensive literature review:

- Characteristics of trust;
- Components for trust;
- Conditions of trust;
- Levels of trust;
- Operational basis for trust;
- Evidence of trust; and
- Trust in the market (Smyth 2003).

This paper focuses on the *components of trust*, which are key dimensions for analyzing the extent to which trust develops in ways that enhance relationships to improve performance. These

are intangible dimensions in a relationship that become evident through behavior and functional outcomes in project management. The perceptions of one party concerning another provide evidence of the presence of intangible *components of trust*, establishing a measurable benchmark for relationships, the evidence collected within the context of other framework elements, namely, evidence of trust within the operations and collected from senior management levels, hence linking to the last three elements in the framework.

It is necessary to define *components of trust*. The components comprise a family of related concepts that act as the dynamics in relationships, helping convert expectations to probability statements of successful outcomes. Trust is the mediator. Trust is embodied in relationships with other parties. The components, together with trust are

- *Expectations* in the relationship performance of other parties;
  - a. *Faith* in the unseen capabilities of other parties to perform; and
  - b. *Hope* in the seen capabilities that other parties will perform.
- *Confidence* in the other party derived from evidence in recent past performance within relationships.

This bundle has been developed from the first exposition of the framework (Smyth 2003). Here we differentiate expectations, adding *hope* to *faith*. Faith is an expectation based upon what is perceived as possible yet is unseen in terms of evidence, whereas hope is based upon what has been seen and is perceived possible in circumstances being faced. Logic places this family of components prior to other sociological or psychological concepts, that is to say, antecedents cannot be identified within these disciplines (Smyth and Thompson, unpublished, 2005). Hence they provide a valuable “raw material” for examining the robustness of relationships. The connections between the components are shown in Fig. 5.

The dynamic is that as trust mediates between the *expectations*—faith and hope—confidence, a probability statement, is built upon successful outcomes, hence performance. This in turn permits expectations to be raised to a higher level with the potential for further deepening of relationships if the parties remain willing to trust. Hence the stakes rise until trust is eroded or

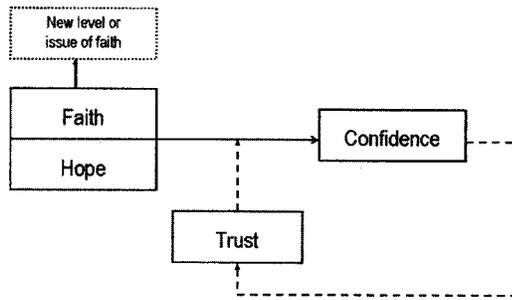


Fig. 5. Components of trust

broken and expectations are either lowered or all goodwill is spent.

Transaction management tends to lead to legal contracting on projects. *Legal contracting* is more apparent, hence tangible, than *relational contracting*. “Legal contracting” is defined as being guided by the “spirit” and terms of the contract, the spirit meaning the written and informal systems and procedures used that are not part of the contract terms yet are used for guidance and are sometimes colloquially referred to on projects as “following or going by the rule book.” It is essentially technocratic or bureaucratic rather than relational in primary emphasis. Under these definitions there are two drivers—relational and legal contracting. These drivers do not exist as two isolated poles or modes of operation, but can be located upon a conceptual continuum.

The premise is some people use *intangible* relationship factors for performing their roles and functions. Positive behavioral *evidence*, derived from the relationships, encourages people to use the path of least resistance in terms of administrative bureaucracy—often a preferred path of performance to undertake contracts. Individuals do not typically resort to legalistic behavior or directly revert to the contract terms unless problems arise, except where problems appear to be intractable or unresolved.

In contracts encouraging relational contracting, such as PPP, the organizational systems and procedures would be expected to provide scope for relationship development by utilizing principles from the *relationship management* paradigm. This will theoretically create high trust environments, which are sustainable providing all parties show a willingness to trust and invest in relationship development at both individual and organizational levels.

However, the premise that people rely upon relationships for effective performance breaks down as problems become increasingly intractable. In such circumstances, tangible benchmarks are sought, initially various means that require an emphasis upon accountability, and after that a common denominator, typically the contract. The contract terms provide guidance to resolution. Further dispute at this level has the consequence of moving from using the contract as guidance to determination upon legal advice and interpretation, ultimately through litigation in a court of law.

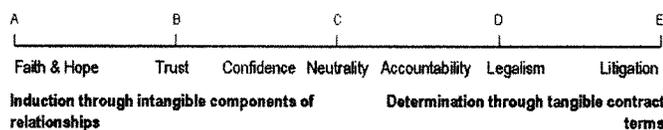


Fig. 6. Relational-legal contracting performance continuum from intangible induction to tangible determination

In many instances, such problems may surface as technical or functional, yet ironically end up as intractable relationship problems of adversity.

The depiction of *relational* and *legal* approaches to contracting on a continuum is shown in Fig. 6. On the relational side of the continuum, confidence is located closest to the central or neutral point. The absence of confidence can cause trust to stagnate or be eroded. Where a number of events conspire to show an absence or low level of trust, the trust or goodwill is fragile and easily eroded. On the other hand, high confidence levels provide evidence, albeit relatively intangible or tacit until articulated explicitly, for the relationships to deepen. On the legal side of the continuum is accountability. Accountability suggests that relationships are providing insufficient evidence and that considerable evidence must be demanded to ensure or be assured of satisfactory performance. In the continuum, accountability is therefore used in the sense of being a driver moving toward a legal contracting approach, hence conveying the message, “I don’t trust you.” In a societal context Anora O’Neill in the annual BBC Reith Lectures has cited such demands for accountability as a critical political and cultural issue:

... the new culture of accountability provides incentives for arbitrary and unprofessional choices (O’Neill 2002a).

While a lawyer would insist that referring to a contract is entirely professional, just as writing one is wise, and those who measure performance would concur and insist upon the necessity of performance indicators, such assertions would serve to miss the point. Accountability is indispensable. However, when accountability is the primary driver in order to gain evidence of performance, such means are used to hold others to account in the sense of holding up proceedings and adding to transaction costs. This is different from using accountability as feedback in order to improve performance and hence increase efficiency in terms of productive time and cost reduction. In this context, policy informers and makers, such as Egan (1998), have failed to identify an appropriate balance between trust and accountability measures, such as key performance indicators (KPIs). KPIs by default reinforced procurement driven approaches and thus inadequate consideration has been given to relational contracting or strategic relationship marketing issues by suppliers (Smyth 2005).

Legalism, further down the continuum (Fig. 6), embraces legalistic behavior, where “baggage” from past experience is brought into current circumstances in order to ensure the procedures, rules, and contract terms are being followed to the letter. Such behavior imposes costs. At worst, legalism induces behavior where service providers or clients are “covering their back,” and both can become more concerned with meeting the criteria of the other party than the real benefits that the service was set up to provide. Such behavior can lead to a breakdown in trust, hence relationships. The service provider or client may decide to become opportunistic, using game theory plans to serve best self-interest above general welfare, even though their overall level of welfare may also recede under such adversarial circumstances (cf. Hobbes 1994; Williamson 1985).

Legal contracting tends to “dispense” with relationships as a means to perform and improve performance, rule book and contractual issues becoming the primary means. Transaction management and legal contracting use relationships as deposit boxes for communications to ensure that subsequent actions of the other party are guided by the rules and contract terms. The movement along the continuum from accountability to legalism can resort in other parties acting adversely in response to communications. At

a personal level the individuals may simply feel undervalued, possibly influencing behavior. At a business-to-business or organization-to-organization level such accountability and legalism tend to cause transaction costs to increase, which is a major management issue in the management of projects (Winch 2002). The service provider is likely to respond in two ways:

1. Defensive response in terms of content: address requests for information and communication from a legal or contractual viewpoint at a sufficient level to minimize transaction costs yet ameliorate the request; increasing asymmetry by retaining as much information as thought defensively necessary (cf. Milgrom and Roberts 1992), hence opposing greater willingness to share information expected in trusting relationships (Wood et al. 2001; Smyth 2003).
2. Aggressive response in terms of behavioral atmosphere: address requests for information and communication as an invasion of or challenge upon capabilities and competencies of the enterprise and the project teams, leading to adversarial relations.

The combination of defensive and aggressive responses in content and atmosphere, respectively, is likely to escalate the demands for greater levels of accountability and legalistic behavior from the client. This process increases the likelihood of moving toward legal determination, perhaps through dispute resolution procedures or ultimately in court through litigation. At these stages all trust and goodwill have been eroded and adversity prevails. In other words, relationships have paradoxically risen to the fore.

Most disputes are resolvable without incurring extensive transaction and legal costs; however, the breakdown in relationships erodes the means by which to achieve resolution. The introduction of independent arbitrators in dispute resolution tries to overcome this demise with some success. However, in the United Kingdom the legal profession earns more fees from the construction sector than any other, seeking legal determination and litigation being high transaction cost outcomes.

In summary, a conception of *relational contracting* has been defined, locating trust as a key measure of high performance levels achieved through effective personal relations and the application of *relationship management* concepts at an organizational level. A definition of *legal contracting* has also been provided, derived from tangible evidence of actions and communications which use technocratic or bureaucratic principles that try to be distant from relationships as a means to induce effective performance and keep transaction costs low. It has been argued in the paper that legalistic approaches tend to invoke adverse relations, hence constraining a means to overcome problems. Intractable problems will ultimately be resolved through arbitration or litigation.

## Case Context

There are over 625 PPP contracts placed representing total capital assets of £39.9 billion (c.US\$74 billion) in the United Kingdom. This has transformed the renewal of public service delivery, providing 34 new operational hospitals, 239 new and refurbished schools, and a range of other public facilities. According to KPMG (2004) PPP accounts for around 10% of total public investment.

U.K. governments pioneered the PPP market, with other nations following this lead. The United Kingdom has over 10 years of experience, the market starting under the policy of the private finance initiative (PFI) in 1992, becoming the generic policy

package of PPPs post-1997. This paper will continue to use the term PFI as the policy name, with contracts being identified by their service content.

The inception of PFI was part of a developing policy to increase the use of the private sector in the public arena and the transference of risks to the private sector. PFI became a primary means to increase investment without exceeding prescribed borrowing limits, initially those imposed by the European Union (EU), and later by the U.K. Chancellor's "golden economic rule" that increased borrowing will only be sanctioned if for future investment. PFI was recognized as too inflexible, with contracts essentially being let as design, build, finance, and operate (DBFO) concession packages. DBFO contracts were sometimes failing the business case, that is, *value for money* assessments required prior to publicly publishing the intention to let a concession contract through an OJEC notice. PPPs were subsequently created to broaden the policy remit, PFI having been blamed for both high cost and long lead times during PFI bidding stages. Thus, in limited cases, publicly funded PPP construction contracts are allowed by Government. The public sector has moved from input specification as a benchmark for comparing bid prices to a normalized position of procuring services upon performance criteria. The criteria are established from output specifications, key performance indicators (KPIs) being used to ensure criteria are met over project life cycles.

There is now a range of contractual vehicles employed, including term agreements with service level agreements (SLAs) and highly complex DBFO and DBO contracts. Many projects are construction related PPPs including roads and other transport systems, civil engineering based facilities, such as water treatment plants, and serviced accommodation, offices and residential accommodation, and highly complex environments of schools, universities, prisons and hospitals. The focus for this research is DBFO and DBO type contracts.

In the case of DBFO, public sector clients (PSCs) aim to maximize risk transfer to the private sector. The submission of the bid documents will have provided significant outline information on the design and construction, as well as pricing information that will be incorporated within the total pricing information and financial model. In this case the financiers, the suppliers of the debt finance, are part of the SPV consortium. Once signed, the client will transfer the entire project to the SPV under a DBFO-type contract.

In the case of DBO, PSCs aim to transfer risk to the private sector for construction and operations. Finance is directly provided by government. Protocols are established for delivery of built assets and operations as DBO-type contracts, PSCs having representatives to approve achievements at various milestones, for example, completion of design.

There are many uncertainties at the outset of a contract, which under traditional procurement would give rise to claims. Under PPP, detailed decisions will have to be paid for by either the design and build (DB) contractor organization, from what can be considered as design development budgets, or the operating contractor as the core service provider. The DB contractor may also be involved in operations through all or parts of facilities management service delivery. The long-term nature of the project life cycle provides a theoretical incentive to maintain harmonious relationships as the same organizations, and for long periods the same individual staff, are going to continue to work together. Adversarial relations can carry forward a debt on the bottom line of the social balance sheet, whereas trust is an investment that yields a return on the bottom line of the social balance sheet.

The existence of uncertainties implies trust is needed between the parties that reasonable solutions will be identified at the right time. Determining solutions will be developed through the partnership, hence through key long-term relationships of individuals.

The range of PSCs engaging with PPP contracts from well-established central ministries through to small specially created organizations is extensive. These client bodies were generally required to understand PPP principles through experience, for although guidance is provided, many PSCs only gain prior knowledge from one or two contractual experiences. The very small number of emergent "expert" PPP procurers led government to introduce central advisory facilities, units, and gateway reviews to attempt to resolve numerous hurdles and obstacles that PPPs can produce. Such steps were taken to develop best management practice in PPP procurement. It is also hypothesized that relationships are affected by experience, the absence of direct experience meaning that parties use past practice to inform their behavior, some of which may be inappropriate. This raises the central research question for this paper as to whether variance of experience between different client procurement teams affect the success of projects over their life cycles, in particular along the relational-legal contracting continuum.

PSCs operate at two levels: with public service client central level staff (PSCCLS) and with public sector client local level staff (PSCLLS). Policy making and directives are determined top down; however, attitudes and behavior at a local level have an affect upon contract implementation over the project life cycle, the total cycle ranging from 25 to 40 years. A secondary research concern is the influence of central and local levels upon contract performance in terms of the relational-legal contracting continuum.

This section has reviewed the context for DBFO and DBO contracts under PFI and post-1997 PPP policies. The motivation is to renew public services in providing new capital assets and operations over long-term concessions of 25–40 years duration. The project life cycles are therefore long embodying inherent uncertainties and hence risks. Known costs and quality based upon output specification and managing project uncertainties can be managed at any point along the relational-legal contracting continuum. The context gives rise to potential variance in management approaches according to the experience and understanding of client project teams. The teams operate at a policy-making central level and a local level of operational delivery, giving rise to further permutations for service delivery variance. It is these issues that provide the primary research focus.

## Methodology for the Case Studies

The two research questions for exploration can be summarized as:

1. Whether variance of experience between different client procurement teams affect the success of projects over their life cycle, in particular along the relational-legal contracting continuum is in evidence.
2. What is the influence of central and local levels upon contract performance in terms of the relational-legal contracting continuum?

The research has been conducted in two stages. The first is based upon an action research methodology, which is qualitative. The second is based upon a traditional quantitative survey methodology, using a small pilot sample which represents a significant value of PPP contracts (£0.5 billion or c.US\$0.94 billion).

The action research methodology is primarily ethnographic,

whereby participation and observation is combined within the primary actors (Dunnette 1976). The participative element of action research has permitted access to a detailed level of data and hence understanding. Active participation has also led to influencing the shape of service provision, especially in the area of risk management with the consequences that actual and perceived risks are identified, managed, or reduced where information uncertainties can be overcome (cf. Winch 2002). Such participation had the aim of providing conditions in which trust and goodwill between the parties could be favorably developed. Therefore, processed data is partially an outcome of particular actions, informed by values held by the action researcher. This is quite legitimate for two reasons. First, the depth of data articulation and understanding from which this analysis is derived could not have been achieved by other methods. Second, all research is informed by values (Krieger 1979). The data collected in this ethnographic way is informed by values that have been brought through all the parties. Such values are a reflection of what is considered of importance, hence, the research is shaped by this. Yet all research is shaped in some way, including the values of independent parties—what the researchers or funding organizations consider as important.

The action research was focused on a PPP consortium for a period of 3.5 years. This has given access to extensive and rich yet highly sensitive data, which has been distilled to identify the primary trends in the context of legal and relational contracting. The data from this source is largely qualitative and the analysis is interpretative and evaluative, derived both from academic evaluation in relation to theory and methods, and derived from both professional and previous career experience, as well as experience gained through the action research approach.

The main constraint of this methodology is the richness of the data. First, the analysis has been developed through sifting and distilling data; however, which information is determining long-term processes and outcomes is not always clear at the time, both in terms of the significance of particular events and the combinations of events and information that become of critical importance. Second is the confidential nature of field, having access to such data means being in a very privileged position, with consequent obligations to respect the data owners sensitivities. The public policy area of PPPs is highly sensitive politically for the client and sensitive in terms of confidentiality and tact for the SPV partners in relation to implementing successful contracts and securing repeat business. Therefore access to data has been contingent upon keeping the parties and the projects anonymous. The reliability of the case material in one sense is dependent upon academic traditions and rigor; however, in this case accountability is restricted as interested readers are unable to verify the research by following up with the cases directly. This does not compromise the legitimacy of the research questions as the aim is to provide analysis for the benefit of future PPP contracts in the United Kingdom and around the world. It creates, however, an issue for demonstrating how the action research analysis was conducted in detail. This issue is partly overcome from mobilizing the second methodological approach.

A traditional quantitative survey provides the second method. It was argued that the action research provides a platform for a broader study of a series of PPP service providers for different construction types and procurement options within the whole PPP market. The second method is a pilot to determine feasibility for a more extensive study. The aim was to conduct at the end of the action research a snapshot of the extent of the *components of trust* within relational contracting in order to establish a benchmark as

to how far along the continuum of relational and legal contracting the pilot had progressed to date. This will then act as a comparator for further research.

A survey was devised, using 3-point Likert scales, to establish a rating for each component of trust, hence measuring closeness of relations amongst key players. The research snapshot focuses upon behaviors as experienced, hence perceived, by the recipient, that is, the party responding to the survey. The survey enquired about the following:

- The extent of *confidence* the party has in those representing the other party to resolve issues based on past performance;
- The extent to which the party has *hope*—positive operational outcomes that are currently seen as possible—in those representing the other party; and
- The extent to which the party has *faith*—positive project outcomes that are unseen yet believed possible—in those representing the other party.

In terms of the expectations—faith and hope—these are formed by the responding party based upon their perceptions of how the other parties are behaving. In exploring individual perceptions and expectations, PPP provides a long-term contractual environment that is based on a premise of stability. Therefore it is reasonable to anticipate a priori that individuals factor into questionnaire responses their own *expectations* on the relationships involved in the PPP. Thus their answers are their *perception* of relationships, conditioned only by the expectation of how such relationships could have been. This assessment is implicit in the way the questions were formed. As the research was seeking to explore this important area, there were no hypotheses to test and, therefore, an important contribution that can be derived from the results obtained is that it is a reflection of how those involved perceived the situations and relationships with which they are a part. The position of trust within the data relates to its mediating role between expectations and confidence. The evidence provided in this research is in line with other direct questions concerning the characteristics and conditions of trust found in the framework and reported upon elsewhere (Edkins and Smyth, unpublished 2005; Smyth 2006; Smyth and Thompson, unpublished 2005).

The nature of relations across the SPV and with the client could then be analyzed. The survey is based upon a total net present project value covered by the pilot population of £0.5 billion (US\$0.94 billion). The PPP case studies consider services delivered for one government ministry. This paper has disaggregated the survey data along two project dimensions according to construction type, hence services, for which there were two sets of personnel in the client body. The cases shall be referred to as Cases A and B. Case A represents £450 million (c.US\$846 million) and Case B represents £120 million (c.US\$225 million). The SPV parties are significant players in the market PPP, consisting of a facilities and operational management company, plus a design and build contractor and financiers where DBFO projects are involved. An external legal adviser is also part of the project team, supplementing an in-house legal team on all projects. Key SPV personnel, defined as executive and senior management with key decision making powers constitute the pilot population for service areas, Cases A and B. The breakdown of the population sample is shown in Table 1.

The survey focused upon intangible data, hence evidence not covered through action research. The data relates to perceptions of relationships and relationship management in relational contracting, in particular the *components of trust*. These intangibles provide a benchmark for the relationships, which are assessed

**Table 1.** Pilot Population

Organization	Sample size	Returns	Response rate (%)
SPV	4	3	75
Operator	3	2	67
DB organization	4	4	100
Legal adviser	3	1	33
Total	14	10	71

Note: SPV=special purpose vehicle; Operator=service and FM contracting organization; DB=design and build organization; and LA=SPV's external legal adviser.

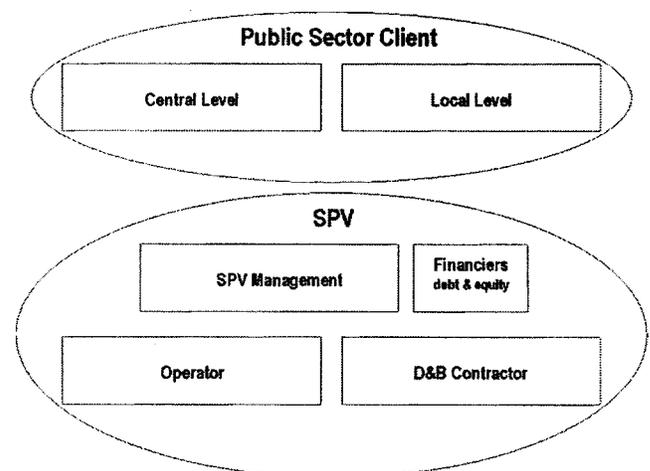
against tangible action research data to establish the degrees to which relational and legal contracting are used.

## Case Study Findings

The two case studies concern two service areas of delivery for one government ministry using PPP. The two case study areas began their policy life under PFI/PPP on a similar footing regarding trust. At a behavioral level the two sets of public sector client central level staff (PSCCLS) were “finding their way” and demonstrated preparedness to shelve assumptions, preconceptions, and predispositions. Experiential baggage was brought to bear as the market unfolded and experience invoked and induced attitudes and behavior from past practice, as the cases will clearly demonstrate.

The case study service areas are similar in functional character. Both are politically sensitive service hence policy areas; although Case B is perhaps more sensitive to short-term political factors than Case A. The organizational structures are shown in Fig. 7.

Although the Special Purpose Vehicle (SPV) is the formal organization the client contracts with, this is a shell or “virtual” organization, the SPV management being formed from representatives from the other organizations. All substantive implementation is conducted through the various operational organizations and their employees. The organizational scheme is essentially the same for the two cases. The only variant comes with the procurement route rather than the type of facility. The financiers are present in the DBFO variant and absent in the DBO-type of PPP contracts.



**Fig. 7.** Organizational scheme

The qualitative findings from the action research show contracts that were organizationally similar. In principle there is an understanding of the “one-stop-shop” nature of the project challenge offered within PPP; however, the team experience and understanding among PSCCLS varied between Cases A and B. PSCCLS in Case A demonstrated greater willingness to explore new practices, adopting a greater level of trust in the SPV members and their staff.

Improved performance has generally been achieved compared to traditional procurement. This supports broader evaluation of PPP by bodies such as the National Audit Office: emerging delivery data of the buildings and facilities procured under PFI and PPP show they are delivered more quickly, typically on or near budget and with fewer faults and defects. This has been identified as a major success of PFI/PPP, albeit with a growing concern by building design critics that there is little of architectural merit from the vast majority of buildings from this genre (see, for example, CABE 2002).

When changes were demanded, PSCCLS in Case A generally understood that there were contractual implications for SPV members. It was understood that these SPV parties were also working together in the long term, hence both relational and legal factors were appreciated and scope given to the parties to address recommended changes at points along the relational-legal continuum perceived to be suitable by the parties. Behavior tended to be at the relational end of the relational-legal continuum at the outset.

In contrast PSCCLS in Case B demonstrated less understanding of the one-stop-shop nature of the project, with apparently less concern for relationship effectiveness over the project life cycle of the concession term. This may be due to the shorter contract duration for DBO compared to DBFO-type contracts. The result has been that the public sector client local level staff (PSCCLS) relied upon baggage from past experience to inform actions. Behavior tended toward the legal side of the continuum. Behavior has varied at different times, although overall has gradually shifted from clear accountability in administrative and technocratic terms toward a legalistic position. Changes demanded by the PSCCLS for Case B were typically presented as demands for immediate response. There was a lack of recognition that some changes driven by legalistic habits derived from traditional and frequently adversarial contracts actually infringed contract terms between the PSC and the SPV. The response by the SPV organizations was typically defensive, drawing attention to legal ramifications, including the implications for contract terms between SPV organizations. Such defensive responses were coupled with more aggressive secretiveness that increases information asymmetry.

A number of changes required had consequential functional aspects for the service. Examples include changes to the spatial configuration of constructed facilities as operational practices changed. These demands constituted variations to the contract. Resolution is not simply a function of releasing additional financial resources to make the design or spatial changes because there are consequences to other services for other parties in the SPV for the remaining project life cycle, for example, for cleaning and maintenance services. This then impacts upon performance measurement criteria, which in turn affect the risk profile, financial model, as well as the cost base of the SPV.

A number of changes also affected output specifications. These typically involved service measurement, using KPIs and other performance criteria. Over time, transactional views resurfaced where PSCCLS appeared to wish to directly manage outputs, yet

were contractually frustrated from so doing, and hence turned attention toward input measures, challenging whether certain inputs could achieve output specification criteria. The PSCCLS approach depended upon the individuals in post and these changed, so there have been a range of views from those that endorsed the contract—“spirit” and terms—to those that contradicted them.

Local level staff and representatives (PSCCLS), who are close to the problems and challenges, occasionally adopted partisan views, perceiving situations as “them and us.” This disposition becomes partially transferred from the PSCCLS to SPV staff through risk transference embodied in PPP. This resulted in situations where the operating contractor relied on key contractual phrases such as “fitness for purpose” and where any detailed specification received by the DB contractor is considered in terms of a potential claim, resulting in some scope for adversarial behavior. Key staff should understand the relationship requirements, being suitably trained and having investment made in team building exercises where the individuals and organizations are unfamiliar with each other. In both Cases A and B organizations relied upon individuals to adapt and learn how to behave. *Relationship management* concepts were partially understood and hence implementation in investment, systems, and procedures was uneven and an overall frame or model absent (cf. Figs. 2 and 3, greater reliance placed upon individual behavior, and cultural norms being established amongst team members. Case A demonstrated greater propensity to identify, understand, and develop appropriate behavior according to contract requirements than PSCCLS in Case B.

There is also a link between central policy formation and local operations. In the example, the monitoring and enforcement by client representatives of performance according to contract output specifications is insufficient to ensure the smooth operation of facilities. Therefore core services are being delivered using a range of operational procedures, systems, and processes that are simply too detailed to be included within the contract. This provides the basis for differences of perception as individuals have their own views on how things should be done. The traditional approaches that the clients used in the past may be advocated by the local client representatives, yet be rejected by the private sector operating company within the PPP concession contract.

Another example of central-local dynamics is provided by the move made, over time, to refocus the measurement from outputs achieved toward inputs. A common area of contention is staffing levels. If a service, say the cleaning of specific areas, is specified in terms of the frequency and standard of cleanliness, then the operator has the risk, responsibility, and challenge of putting in place the necessary resources to deliver the required output. Thus, in the example, the public sector client is not contractually concerned with issues such as the employment levels of cleaning staff. In practice, local client monitoring staff are close to the detail. They may allow traditional public sector approaches to influence their comments and concerns. The risk of this happening is exacerbated by the complexity of the contract documentation, and the remit that local client staff have of the perception of their remit. The long length of the contracts would suggest that local custom and practice can, over time, push aside the official contractual requirements. Such shifts in behavior can have an impact upon expectations, and through trust, upon confidence levels in the relationships and hence affect future behavior in resolving issues. The issues which such behavioral shifts induce cannot be eradicated by simply tightening contract terms at the outset.

Resorting to the terms of the contract in relation to accountability, legalism, and litigation has become more prevalent, espe-

cially on Case B projects. This is a considerable problem. Not only is each contract complex, but there is not a standard contract for DBFO or DBO projects. The level of influence that overseeing agencies, such as Partnerships UK, has on using standard terms, clauses, and style, and the firms of lawyers and other specialist consultants that are used to draft the actual documents varies for each project. The National Audit Office, amongst a number of influential observers, made clear the complexity of contract demands: PSCs that are unfamiliar with the use of PPP draw upon such expert guidance and previous experience to avoid recognized pitfalls. This has broadly worked through the government Gateway Review process, with projects not being sanctioned unless they comply with the expectations for a consistent approach in principle; however, it is recognized that projects are heterogeneous in nature and therefore a “one-size-fits-all” approach to contracts is unlikely.

The contract proposed by the PSC is required to be interpreted by those that have passed the initial criteria for eligibility to bid. This introduces the major issue of perception. The potential bidder and their advisers have to use their expertise, experience, and judgement as to whether the draft contract is capable of being acceptable to the various boards of directors and possible third party financiers who will have to ultimately agree to sign. It is almost certain that there will be elements of the draft that are unacceptable and the procurement process will provide various mechanisms to allow concerns to be raised. Ultimately, the PSC is looking to secure the best overall deal, which means securing the best risk profile for the contract without prejudicing the commercial elements of the bid. Where there is more than one bidder, the competitive nature of the bidding process would normally limit the desire to reject outright all unacceptable elements. However, the PSC broad objectives for transferring as much risk as possible will result in pushing the private sector to their limits of commercial tolerance, hence behavioral “comfort zone.”

The move from open bidding to the selection of the preferred bidder and then signing the contract is a highly complex and relatively volatile process. The nature of what is at stake for 25–40 years contracts means that all details are considered and negotiations can and do take a great deal of time, resulting in considerable expense. This phase of the contract is conducted by a relatively small and often very senior group of individuals. Representatives from both sides of the contract will establish the points that they would never be prepared to concede and then the challenge is to bring often diametrically opposed views together so that a deal can be agreed. There can be, and regularly is, considerable contention concerning aspects of a contract. These are determinate as tangibles, although the relationship dynamics are less quantifiable and arguably more significant for project outcomes.

Resolution is found through iterative rounds of discussion and negotiation, seeking agreement on individual issues. Many of the contractual clauses in these contracts will cross-reference to more detailed schedules of information. By combining the implications of the clauses with detailed output specification, clear obligations and consequences are identified. The response of bidders is normally to find a solution they can deploy and manage with an attached price. There are, however, a number of areas in contracts that will be straightforward statements, covering areas such as

- Changes to taxation, such as VAT;
- Legislative changes; and
- Insurance policy requirements in relation to insurance market risks.

Contracts will also have significant detail on:

**Table 2.** Survey Findings for Components of Trust within SPV

Relationship	Case A		Case B	
	Rating	Percent of maximum score	Rating	Percent of maximum score
SPV-operator	10	67	9	60
SPV-DB	13	62	7	33
SPV-LA <sup>a</sup>	3	100	0	0
Operator-DB	7	39	5	28
Operator-LA <sup>a</sup>	3	100	3	100
Total	36	62	24	43

Note: Percentage figures have been rounded up or down to the nearest figure. SPV=special purpose vehicle; Operator=service and FM contracting organization; DB=design and build organization; and LA=SPV’s external legal adviser.

<sup>a</sup>The legal adviser is external to the formal contracts within SPV organizations, hence the measure is by the legal adviser of the other SPV organization, whereas the other measures are two-way.

- Contractor default; and
- Contract breach position.

These elements combine to generate risk-averse thinking in the SPV, derived from sets of hypothetical worst-case legally informed scenarios that consider contract default and breach, unavailability of insurance, *force majeure* issues, and so forth. At this point the executive members across the SPV determine their maximum commercial position of risk exposure in the light of the critical factors listed above. This position is then taken to open negotiations with the PSC. The final agreement reflects the relative power of the monopoly client and the temporary monopsony supplier as the preferred bidder. Such negotiation can heighten tensions, which can then inform the subsequent behavior in contract implementation, which has been in greater evidence for Case B, especially where there is political urgency behind service need.

Therefore the action research shows that there has been a shift from the relational side of the continuum toward the legal side over a 3 to 4 year period. Case B soon moved toward accountability and has subsequently moved further to the right of the continuum at central level, reinforced by PSCLLS in implementation.

The survey findings are based upon Cases A and B, exhibiting different performance in respect to the relational-legal contracting continuum. The findings show reasonable levels of trust components within the SPV (Table 2). The extent of relational contracting within the SPV parties is therefore sound. The comparative percentage scores, 36 for Case A and 24 for Case B, indicate that there are higher levels of trust components in operation for Case A, suggesting that the relational contracting can be located approximately in the range A–C for Case A and B–D for Case B on the relational-legal contracting continuum (Fig. 6). Trust is therefore more fragile between SPV organizations for Case B, which is likely to depend upon external factors as the personnel are constant within the SPV—tensions arising within the SPV caused by different relations with client staff.

Differences between the cases may to some small extent be the result of inconsistent or erratic behavior of individuals within the SPV organizations—individuals taking responsibility for behavior rather than organizational *relationship management* principles being used to guide behavior. Hence there is an absence of remedies to improve or develop trust within these organizations (vertical dimension, Fig. 4).

The action research data supports this proposition as there are

**Table 3.** Survey Findings for Components of Trust with Client

Relationship	Case A		Case B	
	Rating	Percent of maximum score	Rating	Percent of maximum score
SPV-PSCCLS	3	33	-9	-100
SPV-PSCLLS	3	33	-6	-67
Operator-PSCCLS	-1	-17	-6	-100
Operator-PSCLLS	0	0	-6	-100
DB-PSCCLS	1	8	-3	-25
DB-PSCLLS	3	25	0	0
LA-PSCCLS	3	100	0	0
LA-PSCLLS	1	33	-3	-100
Total	13	22	-33	-55

Note: Percentage figures have been rounded up or down to the nearest figure. SPV=special purpose vehicle; PSCCLS=public sector client central level staff; PSCLLS=public sector client local level staff; Operator=service and FM contracting organization; DB=design and build organization; and LA=SPV's external legal adviser.

no other extenuating factors that would suggest that the SPV personnel across the organizations would have a different disposition to other parties except where transference of adversarial behavior is evident via risk transference criteria in PPP. Paradoxically, Case B projects show greater adversity, where DBO-type contracts are more prevalent. This would suggest that transferring finance risk permits the SPV to use relational contracting within its boundaries to resolve some issues (Case A), while direct government financing gives PSCCLS greater scope to be aggressively demanding in ways that can erode trust (Case B).

Disaggregating the data further, the scores for confidence in performance are 14 for Case A and 8 for Case B within the SPV, suggesting parties are generally successfully resolving issues even when immediate solutions are not apparent. Expectations for future performance score 25 in total for Case A and 19 for Case B, showing that the presence of trust and evidence of past performance has resulted in high expectations of performance and the ability to potentially build confidence amongst SPV parties for future performance. This permits expectations to continue to rise to new levels of faith, as faith held in the past has resulted in unseen possibilities growing into seen possibilities and successful outcomes, especially for Case A projects. This dynamic between confidence and expectation, mediated by trust, is a healthy basis for high performance levels.

Therefore a baseline of operation has been established within the SPV organizations for evaluating the relations between the SPV organization and the public sector client body (PSC). The findings are shown in Table 3, the client staff being distinguished at two levels: PSCCLS and PSCLLS. The findings demonstrate the extent of relational and extent of legal contracting between the SPV parties and the client body. The comparative percentage scores, 13 for Case A and -33 for Case B, indicate that there is overall a poor level for Case A of the trust components in operation between the client and SPV organizations: less than half that found within the SPV parties. It is negative for Case B, where distrust or even mistrust is present to a considerable degree. This suggests that the contracting can be located approximately within the range of C-D for Case A projects and D-E for Case B on the relational-legal contracting continuum, demonstrating a predominance of legal contracting, which at worst is adversarial in nature. Differences between the two cases can only be explained by the difference in personnel and their approach to contractual rela-

tions. The predominant approach is legal contracting and given the absence of relationship management within the SPV, such trust and confidence as exists could be quickly eroded where legalism and litigation are used. This is most likely on Case B projects from the survey evidence.

Disaggregating the data further the net scores for confidence in the PSC are -5 on Case A projects and -2 for Case B projects, providing evidence that resolving issues will be contentious at times, mainly with PSCCLS for Case A and PSCLLS for Case B. The action research data supports this view, showing strong tendencies toward legalistic behavior. Indeed, there have been times when recourse to contract terms is used to resolve issues and when differences of legal interpretation have commenced the process of pursuing determination through the courts. Indeed, in Case B one major project issue may fail to be resolved before reaching court.

SPV expectations of PSC relational performance score 11 for Case A yet -21 for Case B projects, showing that it is fully expected that relationships are likely to deteriorate for Case B projects. Case B projects are therefore operating against the grain of PPP policy aims overall. While expectations are not an automatic guarantee of actual relations for the future, individuals are likely to gear their behavior in defensive ways in anticipation of the likelihood of greater adversity, which can induce a "self-fulfilling prophecy." This dynamic between confidence and expectation, mediated by (a lack of) trust is an unhealthy basis for high performance levels.

The survey findings provide a benchmark of the current position. For Case A this can be summarized as having poor levels of the trust components, which render the SPV-PSC relation fragile, while for Case B underlying relations are not particularly different from non-PPP projects where partnerships are absent. While surface behavior may be amenable most of the time, defensive postures are below the surface and adversarial behavior could surface in the face of contractual tensions at any time. There is evidence from the action research to support this, demonstrating that legalism and litigation processes are present over some issues.

## Analysis of the Findings

Linking the qualitative and quantitative findings produces the following picture. The action research data supports the survey results in the following ways. Case A projects are performing better overall than Case B. Although the SPV-PSC relation is underpinned by good relations among the SPV members, which aids building and preserving trustworthiness at the SPV-PSC interface, there is no corresponding support amongst the PSC.

The action research data is at variance with the survey findings in the following ways. Action research contends that the policy implementation is largely top down, the local level eroding trust in the longer term through bottom up influences in the policy arena. The survey data confirms this general trend, yet at a detailed level shows Case A PSCCLS to be the primary source of relational contention, while it is the PSCLLS that provide the highest levels of adversarial behavior that erode trust. These distinctions may not be in conflict and further comparative research may be able to map the causes and significance of these apparent differences more precisely.

Concerning the two main research questions, analysis of the combined data supports the proposition that there is significant variance in understanding among the public sector clients within

the same government ministry for different service areas. Case A demonstrated clearer understanding; Case B staff demonstrated a reluctance to give up traditional legal and more adversarial practices. This has led to suboptimal relations between the PSC body and the SPV. The public sector expectation is that individuals and their teams are responsible for identifying, capturing, and applying lessons from more experienced parties. There has been little attempt to develop capabilities in accordance with *relationship management* principles.

While Case A exhibits more robust relational contracting with reasonable levels of trust *components*, the operationalizing of positive relational behavior appears to largely be located as the responsibility and remit of individuals. As such the presence of the *components of trust* is vulnerable and quite fragile, especially as a combination of critical events can rapidly erode trust (see, for example, Figs. 2 and 3 (O'Neill 2002b)). It has also been shown that there has been a medium term shift moving toward the right of the continuum. The fragility is based upon relational strengths being reliant upon individuals and their willingness to trust and have confidence in others. Indicative analysis strongly supports the conceptual proposition that *relationship management* principles have been neglected in relational contracting (cf. Smyth 2005, 2006) without any model or framework for developing the principles (see Figs. 2 and 3). This is highly significant for the long-term performance of PPPs if this pattern is replicated elsewhere.

The research question concerning the operation between the central and local levels of the public client has tentatively established that the PSCCLS operate in a predominately top down way, especially with policy formation and contractual guidance and controls. The long-term outworking is being modified to varying degrees by PSCCLS, shifting relations toward legal arrangement on the relational-legal continuum. There is stronger emphasis in Case B, hence exacerbating the legalistic approach at central level too in Case B. It is therefore probable that such tendencies will have an effect upon policy guidance at central level, PSCCLS having a bottom up influence upon policy in the long run.

## Conclusions and Recommendations

It has been demonstrated that there is variance in contract implementation between the two service areas, Cases A and B. This has implications for the way in which government and departmental staff are managed, the development of capabilities to systematically manage new relationships, and contracts arising from new procurement policies being needed.

It has also been shown that relational contracting has developed, yet is fragile in the private sector organizations, being too reliant upon individual behaviors rather than investment and development at an organizational level to embed *relationship management* principles.

In all cases there is a long-term tendency to revert to traditional legalistic contracting driven from the PSC, which at worst is highly adversarial, unless corrective action is taken. The Case B service area exhibited a stronger tendency to move in this direction, based upon behavior established at both central and local levels, from early on at the central level and more gradually at the local level.

A number of recommendations for practice arise from the analysis.

- DBFO-type contracts appear to be more suited to PPP, hence probably relational contracting, than DBO, and will continue

to be so while government staff behave inconsistently, because higher components of trust levels exist within the SPV, giving rise to greater potential to resolve issues through relationship performance.

- SPV members rely too heavily upon individual staff taking responsibility for behavior patterns, giving rise for the need to support this with systems, procedures, and personal development using *relationship management* principles operating within a framework.
- Following from the above, it can be inferred that trust grows from the circumstances and situations that individuals experience; the respective SPV organizations are therefore taking a passive role toward trust rather than actively identifying the means to develop, manage, and commit investment to developing trust, and in the context of this paper, the *components of trust* in particular.
- Government departments have developed processes to guide the implementation of PPP and given some steer derived from the experience of others as to how PPP contracts should be implemented, yet have failed to support this with any guidance upon behavior to support relational contracting from the client side and would seem to have overlooked any need to invest in management principles, such as relationship management, to ensure PPP policy is consistently implemented at a central level.
- Government departments need to impart a clearer understanding at the local level of the policy aims and what the implications are for implementation at the local level.
- Government departments also need to provide tactical support, combined with management principles, such as relationship management, at the local level.

A number of recommendations for academic research arise from the analysis.

- This paper is based upon findings from a pilot study representing significant contract values; however, a broader study of PPPs covering a range of government ministries and a broader range of project types is advocated.
- Further research is needed to map out the causes and significances found at central and local levels of government as far as these affect the behavioral relations and tendencies toward adversarial or litigious relations in contract implementation.
- Further research is needed to establish at a more detailed level if some contract issues, terms, or configurations generally have greater impact upon relationship performance.

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